

**COMMONWEALTH OF MASSACHUSETTS**  
**DEPARTMENT OF PUBLIC UTILITIES**

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Investigation By The Department )  
of Public Utilities Upon Its Own )  
Motion Commencing A Notice Of )  
Inquiry/Rulemaking, Pursuant To )  
220 C.M.R. §12.00 et seq., )  
Establishing The Procedures To Be )  
Followed In Electric Industry )  
Restructuring By Electric )  
Companies Subject To G.L. c. 164 )

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**D.P.U. 96-100**

**INITIAL COMMENTS OF THE MASSACHUSETTS  
MUNICIPAL WHOLESALE ELECTRIC COMPANY**

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**I.    INTRODUCTION**

\_\_\_\_\_ On March 15, 1996, the Department of Public Utilities issued an Order Commencing A Notice of Inquiry/Rulemaking and Setting A Procedural Schedule ("Order") to establish procedures to be followed in electric industry restructuring by electric companies subject to G.L. c. 164. The proceeding will focus on issues enumerated in the Order. See Order at 5-6. The procedural schedule provides for comments to be filed with the Department's Secretary by April 12, 1996 which analyze and propose changes to the restructuring plans filed by Boston Edison Company ("BECO"), the Division of Energy Resources ("DOER"), Eastern Utilities Associates ("EUA"), Massachusetts Electric Company ("MECO") and Western Massachusetts Electric Company ("WMECO"). Order at 6.

In accordance with the procedural schedule, the Massachusetts Municipal Wholesale Electric Company ("MMWEC") hereby submits its comments. MMWEC is a public corporation and a political subdivision of the Commonwealth established by the Legislature to plan, finance and acquire electric power resources on behalf of its member Massachusetts municipal light departments. See St. 1975, c. 775; M.G.L.A. c. 164 App., §1-1 et seq. MMWEC acts as a wholesaler, purchasing electricity in bulk and reselling it to municipal light departments and other utilities. MMWEC is the operator of both the Stony Brook Intermediate (as a 91% joint owner) and Peaking Units (100% owner) located in Ludlow, Massachusetts. MMWEC also owns portions of the Seabrook nuclear plant in New Hampshire, the Millstone #3 nuclear plant in Connecticut and the Wyman #4 fossil unit in Maine. MMWEC's ownership interests in these facilities were financed with the proceeds of revenue bonds the issuance of which was approved by the Department. MMWEC's revenue bonds are secured by the revenues MMWEC receives from the sale of the output of these facilities to municipal light departments which purchase the capability of the facilities under power sales agreements (PSAs). MMWEC does not have shareholders, retained earnings or other sources of funds. Additionally, MMWEC acts as wholesaler of electricity through the bulk purchase of electric power and its resale, through Power Purchase Agreements, to municipal light departments. Finally, MMWEC is the agent of the Department for the purchase and sale of hydro-power generated under the auspices of the New York Power Authority.

MMWEC is a wholesale electric company. It does not sell electricity at retail and relies on the transmission owned by others to deliver the power it generates and purchases. Moreover, MMWEC's charges to its customers are not regulated by the Department. Accordingly, MMWEC's comments focus on issues related to the wholesale electricity market. These issues include (1) market structure, (2) market power, (3) transmission (4) stranded costs, and (5) local property taxes.

Because its members are municipal light departments, MMWEC is also concerned with the effect of restructuring on municipal light departments. MMWEC commends the Department for identifying that impact as one of the issues to be considered in this proceeding. MMWEC understands from the Department's order in Electric Industry Restructuring, DPU 95-30 (1995) that the Department lacks the authority and does not intend to restructure the municipal light departments or to introduce retail competition in their municipal boundaries.<sup>1</sup> Nevertheless, the industry framework adopted by the Department will affect the ability of municipal light departments to survive in a deregulated environment and to realize the true benefits of full and fair competition. In this regard, MMWEC believes that its comments on the wholesale electricity market are also relevant to municipal light departments.

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<sup>1</sup> The Department's order requires only investor owned utilities to file restructuring proposals. DPU 95-30 at 48.

## II. COMMENTS

### A. Market Structure

Four of the five restructuring plans are characterized by retail competition.<sup>2</sup> Under these plans, generation and retail energy services would become competitive, unregulated services. Retail customers would be free to contract with generators, marketers or load aggregators to supply electricity. Transmission and distribution would continue to be regulated or municipally-owned. Generators would have "open access" to transmission and distribution facilities operated by electric companies. All of the plans are premised on the existence of a system operator to coordinate generation and transmission operation and to ensure reliability and system security.

These restructuring plans propose to achieve this market structure by "unbundling" the generation, transmission and distribution functions of vertically integrated companies. The plans of EUA and BECO envision functional unbundling, i.e., the functions which are currently integrated in a single company would be reorganized into separate units or divisions within that company. Separate marketing units or affiliates for competitive power supply services would also be established. MECO's proposed

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<sup>2</sup> In contrast, WMECO offers a "business nearly as usual plan" designed to encourage limited additional wholesale competition through the use of bilateral contracts between utility companies and generators. The centerpiece of WMECO's plan is "NEPOOL Plus," a phased reformation of the New England Power Pool ("NEPOOL").

structure involves reorganizing integrated functions into separate but affiliated companies. DOER's plan would require regulated distribution companies to divest their generation and retail energy functions. In each case the generation and marketing divisions, affiliates or companies would be unregulated while the transmission and distribution business units would be regulated.

For this vision of a market structure to succeed, unregulated generation must be separated completely from regulated transmission and distribution services for those entities that control significant generation and transmission assets in the market. Allowing profit making companies to compete for energy services while they control the means of transmission allows for the erection of market barriers and unfair competition. See Report of the Senate Committee on Post Audit And Oversight entitled A Prescription for Competition: The Restructuring of the Electric Utility Industry, Senate No. 2130 (December 4, 1995) at 43 [hereafter "S.2130"]. Moreover, as the Department has recognized, hybrid competitive/regulated entities will tend to subsidize their competitive services/affiliates with revenues from their regulated services/affiliates. Intra-LATA Competition, D.P.U. 1731, 55 (1985). This not only inhibits competition but also may jeopardize service in the regulated sector.

To realize its goal of full and fair competition, D.P.U. 95-30 at 15, the Department should adopt a framework which

encourages vertically integrated utility companies to divest their unregulated generation and marketing functions. Functional unbundling of services into corporate divisions or affiliates cannot accomplish this goal because it will be difficult for the Department to determine whether such divisions or affiliates are sharing costs, revenues, personnel or information and thereby inhibiting full competition.

The Department can create incentives for divestiture by adopting a rule prohibiting vertically integrated entities from competing for retail customers outside their service territory, continuing to regulate the rates of generators and marketers with regulated affiliates or offering rate of return incentives for companies which choose to divest. By adopting a rule regulating the rates of vertically integrated companies while allowing companies which choose to divest to compete for customers, the Department can create a powerful incentive for the divestiture of unregulated services and affiliates.

All of the restructuring plans recognize the importance of maintaining the regional structure of the existing market. MMWEC concurs with this view. Many of the existing economies in the New England wholesale electric market place result from the regional structure of its interconnected power supply network. Born out of the Great Blackout of 1965, this regional structure, currently embodied in NEPOOL, has proven effective in ensuring a reliable supply of electricity to New England consumers through joint planning and operation of generation and transmission

facilities. Moreover, this regional structure has resulted in capital costs savings for all New England utilities and their ratepayers. Because New England utilities share capacity reserves, each utility requires less capacity to serve its customers reliably than it would as a stand alone system. The regional market structure has also yielded additional economies through the central dispatch of generating resources to meet regional load. If any restructuring effort were to disaggregate the regional structure of the existing market, the economies of that market would be lost resulting in reduced reliability and increased costs. For these reasons, MMWEC concurs with the filed restructuring plans and urges the Department to adopt a rule which encourages that the regional structure of the New England electricity market be maintained.

A competitive market structure also requires the establishment of an independent system operator and the development of a viable spot market. BECO, EUA, MECO and especially WMECO suggest that NEPOOL Plus would provide this function. DOER suggests establishment of a true ISO and a separate power exchange to establish a spot market. MMWEC is an active participant in the NEPOOL restructuring discussions. However, due to the lack of detail and definition associated with the NEPOOL Plus proposal, at this time, MMWEC is not convinced that NEPOOL Plus will enhance competition as efficiently as the DOER proposal. The structure of the ISO and spot market will affect significantly the market's ability to mitigate potential

abuses of market power.

**B. Market Power**

The restructuring plans take highly divergent positions on the issue of market power. Not surprisingly, the Massachusetts retail affiliates of the region's two largest utilities, MECO and WMECO, assert that no New England entity possesses any significant market power. The facts, however, belie this assertion and demonstrate that certain New England utilities possess horizontal as well as vertical market power.

Regarding horizontal market power in New England, over two thirds of the generation is controlled by three companies: Northeast Utilities ("NU"), New England Electric System ("NEES") and BECO. S.2130 at 54; Kremzier Testimony at 8. Further, Northeast Utilities owns 68% of the uncommitted (surplus) generating capacity. Kremzier Testimony at 8. This high concentration of market share controlled by a few participants, or oligopoly, permits only a few firms to gain undue market power.

A utility's market share of uncommitted capacity (installed capacity less firm load) is an indicator of its ability to dominate firm sales in the short run market. Louisville Gas and Electric Company, 62 FERC ¶61,016 at 61,146 (1993). When native load and other firm load is less than annual peak, additional capacity is freed up for shorter term firm and non-firm sales. Therefore installed capacity is an additional measure of market



power. Id.

FERC has held that a 20% or greater share of uncommitted or installed capacity in a geographic market represents market power in that market. Id. EUA's data shows that NU, NEES and BECO have a greater than 20% share in the Massachusetts market and that NU has a greater than 20% share of the entire New England market. See Kremzier Testimony at 8.

Perhaps an even better measure of market concentration is the guidelines used by the Department of Justice. S.2130 at 54. MECO's own analysis demonstrates that the New England electricity market qualifies as a concentrated market under these guidelines. Gilbert Testimony at 22, 25. Accord S.2130 at 54.

In contrast to MECO and WMECO, the filings of EUA and DOER recognize that the electric generation market in New England is an oligopoly. To prevent a few large companies from dominating the market, these entities recommend that an independent system operator ("ISO") control dispatch and transmission scheduling. They also call for the establishment of a power exchange or spot market with a visible spot price.<sup>3</sup> DOER adds that large sellers may be required to sell to the spot market to reduce their market power. Additionally, MECO and BECO recognize that the sharing of information, personnel and costs among affiliates must be addressed. See BECO plan at 24, 25.

MMWEC concurs with the conclusion of the Senate Committee on

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<sup>3</sup> BECO's plan also calls for an ISO and a spot market with a visible price.

Post-Audit and Oversight that public utility commissioners throughout New England should take great care to limit the ability of only a few companies to gain undue market power and to dominate the market for electric generation. S.2130 at 55.

As a consequence, MMWEC urges the Department to adopt a rule which incorporates an ISO/spot market structure with a visible spot price. Like DOER, MMWEC believes that the ISO and the spot market must be truly independent from generation and transmission owners. Because the governance structure under NU's NEPOOL Plus is still being formulated, it is not clear that NEPOOL Plus will afford the ISO with sufficient independence to mitigate market power. It is clear, however, that the current governance structure of NEPOOL, which allows generation and transmission owners to establish the rules and protocols for generation dispatch and transmission scheduling, will not afford the ISO with sufficient independence.

In addition, MMWEC urges that this rule should contain a mechanism by which market participants can monitor for abuse of market power with appropriate penalties or sanctions. For example, generators with potential market power should be required to report information concerning their bids and the availability of their facilities which would permit identification of market abuses.

Even more significant than the existence of horizontal market power in the New England generation market is the vertical power which exists as a result of the large generation owners

also owning essential transmission facilities. All of the restructuring plans filed with the Department recognize transmission access as a significant barrier to the development of full and fair competition in the generation market. Not only can a transmission owner prevent new generation owners from entering the market, but also it can use its control over transmission to give its own power marketing activities unfair advantage over competitors.

Issues associated with transmission are discussed in the following section.

### **C. Transmission**

All of the utility sponsored restructuring plans suggest so-called "open access transmission" regulated by the Federal Energy Regulatory Commission ("FERC") as a solution to the transmission issues. The fallacy in this approach lies in the fact that the New England electricity market is regional. Company-specific tariffs cannot provide the access to the regional generating market needed to achieve full competition. A buyer seeking to purchase electricity from a generator remote of its load's location is faced with paying multiple ("pancaked") transmission rates in order to take delivery of that electricity. Company specific tariffs give the transmission owner an advantage in marketing its own generation over other generators. Moreover, the transmission owner has no incentive to construct necessary facilities and interfaces which would open its service area to

competition from other generation owners. MMWEC agrees with DOER that equal treatment cannot be assured by individual transmission owners who charge comparable rates.

At the same time, the company-sponsored restructuring plans recognize the need for a regional solution to the transmission issue. They suggest that a regional transmission group ("RTG") may provide the answer. However, there is no indication that an RTG will provide open access to the New England market. For example, an RTG may very well be based upon pancaked transmission owner rates. Moreover, negotiations regarding the establishment of an RTG in New England have been languishing for the last five years.

Transmission owners should be required to transfer transmission assets to an ISO. The ISO would be a regulated entity which schedules, operates and expands transmission facilities and charges uniform, regional rates to all users. MMWEC urges the Department to adopt a rule incorporating a common carrier approach to transmission.

Finally, the Department must recognize that it has no jurisdiction over interstate transmission and is unable to control the timing of a regional solution to the transmission issue. Because transmission is of paramount importance to the development of full and fair competition in the generation market, the Department should be extremely chary of introducing retail competition before regional transmission issues are resolved and wholesale competition in the New England market

develops fully.

**D. Stranded Costs**

MMWEC and its member and participant municipal light departments must recover all costs which are stranded as a result of electric industry restructuring. MMWEC and the municipal light departments do not have stockholders who can absorb stranded costs. The rates which municipal light departments charge the residents and businesses on their systems are the sole means of recovering their costs of doing business. MMWEC in turn depends upon the payments from the municipal light departments to pay the revenue bonds issued to finance its power supply system.

There is no unanimity in the restructuring plans filed with the Department with respect to stranded costs. MMWEC believes the Department must establish rules which will allow companies to recover above market costs on a portfolio basis. Further, this recovery will need to be continually monitored and adjusted as the market price fluctuates over the recovery period. If recovery is set at too high a level, then existing generation will have an advantage over new entrants. Conversely, if recovery is too low, then new entrants will have an advantage over existing generators. Even DOER's auction approach cannot ensure an appropriate recovery. It is unclear that there are a sufficient number of buyers for existing generation to ensure correct market valuation. As a result, appropriate recovery of stranded costs will require constant vigilance by the Department.

MMWEC also urges the Department to consider a rule which takes into account the unique issues associated with nuclear generation. MMWEC is a joint owner in nuclear facilities. As such it is concerned about the financial viability of its investor-owned counterparts and the need to operate nuclear plants safely. In addition, decommissioning costs cannot be truly known for many years. Therefore, industry restructuring must contemplate appropriate treatment of these costs including an extended transition period for nuclear stranded investments.

#### **E. Local Property Taxes**

MMWEC is a tax exempt entity but is required to make payments in lieu of taxes equivalent to the local property taxes which it would pay if it were an electric company organized under c.164. Of the plants in which MMWEC has an ownership interest, only the Stony Brook facilities are located in Massachusetts.

To the extent that industry restructuring reduces fair market value, local tax assessments on high cost plants would fall. Conversely, taxes on low cost plants would increase. This would create winners and losers in individual towns but an overall net reduction in local tax payments.

If the availability of stranded investment recovery is used to justify the existing valuation of high cost plants, the offsetting stranded investment credits associated with low cost plants must also be considered. If valuation of high cost plants

is maintained while valuation of low cost plants is allowed to rise, overall utility property taxes would increase, frustrating the Department's goal of reducing energy costs in Massachusetts.

### **III. CONCLUSION**

Based on the restructuring plans filed with the Department, MMWEC urges the Department to adopt rules designed to accomplish the following:

1. Create incentives which encourage electric companies which own a significant amount of generation or transmission relative to the size of the market to divest those assets. Such rules include prohibiting vertically integrated entities from competing for retail customers outside their service territory; continuing to regulate the rates of generators and marketers with regulated affiliates; or offering rate of return incentives for large companies which choose to divest.
2. Preserve the regional structure of the New England electricity market;
3. Incorporate an independent system operator and spot market with a visible spot price;
4. Contain a mechanism by which market participants can monitor for abuse of market power with appropriate penalties and sanctions;
5. Incorporate a common carrier approach to transmission;
6. Allow companies to recover above market costs on a

portfolio basis;

7. Take into account issues associated with nuclear generation, including an extended transition period for nuclear stranded investments; and

8. Result in an overall net reduction in local tax payments by utilities.

MMWEC recognizes that the foregoing recommendations involve actions which may be beyond the scope of the Department's jurisdiction. The Department has indicated that rules which may involve actions beyond the Department's jurisdiction will be intended to establish a policy position. This is a reasonable approach at this stage in the proceedings. However, the Department must deal with such issues directly in the subsequent adjudicatory proceedings. These jurisdictional issues will have to be resolved before true industry restructuring can be implemented in Massachusetts.

Respectfully submitted,

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By its attorneys,

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